



July 1, 2006

Federal Housing Finance Board  
1625 Eye St., NW  
Washington, DC 20006

Attention: Public Comments  
Federal Housing Finance Board Proposed Rule: Excess Stock Restrictions and  
Retained Earnings Requirements for the Federal Home Loan Banks  
RIN#3069-AB30  
Docket Number 2006-03

FirstMerit Corporation is a \$10 billion financial institution headquartered in Akron, Ohio which provides banking services in northern and central Ohio. We are a long standing member of the Federal Home Loan Bank of Cincinnati (the "Cincinnati Bank") and a member of the Ohio Bankers League.

FirstMerit wishes to comment on the Federal Housing Finance Board (the "Finance Board") proposed rule on "Excess Stock Restrictions and Retained Earnings Requirements for the Federal Home Loan Banks" (the "Rule"). FirstMerit is respectfully submitting this letter and requesting the Finance Board withdraw this proposed rule, as it creates a significant undue tax burden and reduces the investment returns to FirstMerit Corporation.

The proposed rule can be reduced to four main requirements. The proposed rule will: 1) Limit the amount of Federal Home Loan Banks (the "FHLBanks") stock; 2) Mandate a minimum amount of retained earnings and eliminate the inclusion of member stock as core equity; 3) Limit the payment of dividends; and 4) Preclude the payment of stock dividends, even though Federal law delegates that decision to local FHLBanks. These requirements will be applied in a rigid, one-size-fits-all format, irrespective of the differences among the various FHLBanks.

#### **Significant Financial Burdens Related to Implementing the Rule**

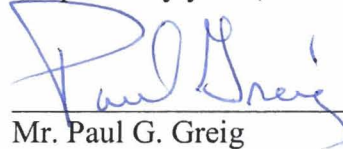
- **The rule will create a premature tax liability on redeemed excess stock.** FirstMerit has maintained its ownership and continues to hold the additional quarterly stock dividends paid throughout the years. We estimate that we will be required to redeem up to \$13.6 million of excess capital stock and incur a significant current year tax burden upon redemption.
- **The elimination of stock dividends with deferred tax treatment and mandatory dividends paid in cash will reduce our income.** The rule will limit the dividend payout to 50% of quarterly earnings until the "Retained Earnings Minimum" (\$50 million + 1% of non-advance assets) is met. In short, the Cincinnati Bank's dividend will be cut

approximately in half and fully taxable. Without the favorable tax treatment of dividends in the form of stock and the limitation of dividends paid, the investment income will be significantly below our return hurdles.

- **The rule implies the capital plan of the Cincinnati Bank is inadequate and FirstMerit's capital stock investment is worth less than retained earnings.** One of the tenants of the Gramm-Leach-Bliley law was to provide for permanent capital in the Federal Home Loan Bank System. In November 2002, the capital plan of the Federal Home Loan Bank of Cincinnati was approved by the Federal Housing Finance Board, and our capital stock investment became permanent capital. The proposed rule implies that retained earnings are the only acceptable form of capital.
- **The rule may cause the Federal Home Loan Banks to be downgraded.** Upon passage of this rule, the FHLBanks will use liquidity currently on their balance sheet and issue additional debt to retire excess stock. The reduction in capital levels and liquidity at the FHLBanks may cause the rating agencies to drop their triple-A rating. If the ratings are dropped and higher retained earnings are required, meeting the liquidity needs of the FHLBank's membership can be affected. The Cincinnati Bank will be required to maintain higher levels of retained earnings, which a risk based analysis would not have generated. If the above outcomes are realized, this will translate into higher borrowing cost and less liquidity for members of the FHLBanks.
- **This rule will limit or even eliminate funding for affordable housing programs.** The rule may cause the elimination of programs which aid financially disadvantaged individuals and organizations. FirstMerit has utilized these programs to help individuals and organizations within our communities.

In concluding this comment letter, FirstMerit strongly urges the Federal Housing Finance Board to withdraw this proposed rule and not impose a one size fits all retained earnings plan. FirstMerit is aware that certain Federal Home Loan Banks have experienced financial issues in their non-mission related activities and would give cause for the Finance Board to question the adequacy of retained earnings. In these cases, the Finance Board should provide guidance to these Federal Home Loan Banks individually and not impose a blanket rule to all Federal Home Loan Banks equally. This rule can seriously impact financial earnings at many institutions and reduce available liquidity throughout the banking system.

Respectively yours,



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Mr. Paul G. Greig  
Chief Executive Officer  
FirstMerit Corporation